Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Arambula	Analyst:	Nicole Kwon	Bill Number:	AB 1398
Related Bills:	See Legislative History	Telephone:	845-7800	Introduced Date:	February 23, 2007
		Attorney:	Daniel Biedler	Sponsor:	

SUBJECT: Geographically Targeted Economic Development Area Hiring Credit

SUMMARY

This bill would do the following:

- suspend individually offered hiring credits within each geographically targeted economic development areas.
- authorize one hiring credit for qualified taxpayers within a geographically targeted economic development area.

PURPOSE OF THE BILL

According to the author's office, the purpose of the bill is to enact meaningful reforms to the economic development area programs to ensure that the state maximizes its investment in offering the programs and targeted benefits to economically challenged areas and individuals.

EFFECTIVE/OPERATIVE DATE

As a tax levy this bill would be effective immediately upon enactment, but expressly operative for taxable years beginning on or after January 1, 2008.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Existing federal law provides for the existence of empowerment zones and enterprise communities to provide economic revitalization of distressed urban and rural areas.

Under the Government Code, state law provides for several types of geographically targeted economic development areas (G-TEDAs): Enterprise Zones (EZs), Manufacturing Enhancement Areas (MEAs), Targeted Tax Areas (TTAs), and Local Agency Military Base Recovery Areas (LAMBRAs).

Board Position:			Department Director	Date
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Under the Revenue and Taxation Code, existing state law provides special tax incentives for taxpayers conducting business activities within a G-TEDA. These incentives include a hiring credit, sales or use tax credit, business expense deduction, and special net operating loss treatment. Two additional incentives include net interest deduction for businesses that make loans to businesses within G-TEDAs and a tax credit for employees working in an EZ.

Hiring Credit: A business located in a G-TEDA is eligible for a hiring credit equal to a percentage of wages paid to qualified employees. A qualified employee must be hired after the area is designated as a G-TEDA and meet certain other criteria. At least 90% of the qualified employee's work must be directly related to a trade or business located in the G-TEDA and at least 50% of the employee's services must be performed inside the G-TEDA.

The credit is based on the lesser of the actual hourly wage paid or 150% of the current minimum hourly wage (under special circumstances for the Long Beach EZ, the maximum is 202% of the minimum wage). The amount of the credit must be reduced by any other federal or state jobs tax credits, and the taxpayer's deduction for ordinary and necessary trade or business expenses must be reduced by the amount of the hiring credit. Certain criteria regarding whom may be a qualified employee and certain limitations differ between the various G-TEDAs.

Taxpayers operating in a G-TEDA are allowed the hiring credit for employing "qualified employees." "Qualified employees" for G-TEDA are defined by reference to various state and federal public assistance programs. The categories of individuals considered qualified employees for the various G-TEDAs are substantially similar but not identical. A taxpayer located in a G-TEDA is allowed a credit of up to 50% of wages paid to "qualified employees" in the first year, decreasing by 10% each year thereafter. The taxpayer is required to obtain a voucher certificate for each of its "qualified employees." The voucher certificates are issued by the Employment Development Department or the local (within the same G-TEDA as the workplace of the employee) agency familiar with the public assistance statutes.

<u>THIS BILL</u>

For taxable years beginning on or after January 1, 2008, this bill would suspend the hiring credit offered separately under each G-TEDA and authorize one hiring credit for qualified taxpayers that hire qualified employees within the G-TEDAs.

This bill would change the hiring credit percentage to 30% of the amount of all qualified wages paid to a qualified employee during each employment year, not to exceed five full calendar years of employment.

This bill would define "geographically targeted economic development area" to mean an EZ, a LAMBRA, a TTA, and an MEA pursuant to specified sections of the Government Code.

This bill would contain "no inference" language that specifies that no inference shall be drawn with respect to the amendments made by this bill both for the existing law sections being amended, and for the new sections being added, for any taxable year beginning before January 1, 2008.

IMPLEMENTATION CONSIDERATIONS

The department has identified a number of implementation concerns relating to the use of extensive portions of existing incentive provisions in creating the new G-TEDA under sections 17053.76 and 23622.9 of the Revenue and Taxation Code; some of these are identified as examples below. The department has been made of aware of these from its experience in administering the existing incentive provisions. Unless these implementation concerns are addressed, enactment of this bill in its current form would hinder the department's ability to administer the provisions of this bill. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

The bill appears to contain no repeal or "render inoperative" date for the carryover provision under subdivision (k) (3). This creates conflicting information about how to utilize credits generated in taxable years beginning prior to January 1, 2008, and the credits generated in taxable years beginning on or after January 1, 2008. This conflict could result in certain taxpayers utilizing the credits under both of these periods. This conflict could be resolved by amending subdivision (k)(3) as follows: "Notwithstanding this subdivision, the provisions of subdivision (d) of Section 17039 shall apply to allow carryover of credits previously authorized by this section to taxable years beginning on or after January 1, 2007."

The certification requirement in subdivision (c) (1) is not clear what is being certified. The clarification of what is being certified could prevent disputes between the department and taxpayers.

The bill contains numerous terms such as "state rehabilitation plan" and "priority for employment" that are undefined. The author's office may want to clarify this definition in order for the department to effectively administer the provisions of the bill.

OTHER STATES' INFORMATION

Florida allows businesses located in an EZ a credit based on wages paid to new employees. Other wage-based credits are offered to businesses that are located in high crime areas or in rural areas. Job tax credits may be earned by employers, if hired employees reside in the designated EZ or a rural county. Up to 45% of an employee's wages may be claimed as a job tax credit.

New York allows a wage credit to a business that hires a full time employee (either one in targeted group or not) for a newly created job in an Empire Zone.

Illinois, Massachusetts, Michigan, and *Minnesota* do not offer a wage credit to small business employers.

Texas allows EZs to be designated for any census block group with a poverty rate of 20% or more. Currently, there are 169 EZs with no limitation on the number of zones in existence at any one time. Businesses operating in an EZ may claim a hiring credit of up to $1.25 million per year, if 25% of their jobs are reserved for low-income individuals.

Virginia allows 57 designated EZs that were in effect prior to July 1, 2005, to continue in effect until the end of their 20-year designation period.

Most of these states offer assistance such as financial, marketing, licensing, finding employees, tax seminars, and training to small businesses

LEGISLATIVE HISTORY

AB 1550 (Arambula, Stats. 2006, Ch. 718) made various changes and reforms to existing law, among them defining G-TEDAs and allowing the Department of Housing & Community Development to backdate the effective date of the new zone to the date of the previous zone's expiration so the tax incentives remained in effect during the redesignation period.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

Based on data and assumptions discussed below, this bill would result in the following revenue losses.

Estimated Revenue Impact of AB 1398 Effective for Tax Years BOA 1/1/2008 Assumed Enactment Date After 6/30/2007 ($ in Millions)		
2007/08	2008/09	2009/10
-$2	-$15	-$15

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

The revenue impact of the bill would be determined by the difference between hiring credits generated and applied to reduce tax liabilities under the bill and hiring credits generated and applied to reduce tax liabilities under current law.

The estimate of the revenue impact for this bill would result in a $15 million revenue loss for tax year 2008. Estimates were developed in the following steps:

- Amounts of hiring credits generated and applied were compared under the current law and under the provisions of this bill. Applying a 30% flat rate to qualified wages in place of a declining percentage rate would reduce hiring credits generated by approximately 20%, or $80 million for tax year 2008.

- Taxpayers are required to reduce the deduction for wages by the amount of credits generated. The decrease in credits generated increases to the amount of qualified wages that are deducted, that in turn would decrease tax liabilities before applying credits. This amounts to $5 million.
- The bill would limit the use of G-TEDA hiring credits to a taxpayer's tentative minimum tax (TMT). Tax return data for the 2003, 2004, and 2005 taxable years indicates that more than 50%, or $85 million of applied hiring credits reduced tax below TMT.
- The bill would eliminate the $2 million per taxpayer per taxable year limitation on LAMBRA qualified wages. Eliminating this limitation is projected to increase credits generated by $5 million for tax year 2008.
- This bill would allow taxpayers with credit carryovers to reduce tax by twice the amount of tax imposed on their zone income, once for applying new G-TEDA hiring credits and again for applying any carryover credits. Carryover hiring credits are projected to exceed $1 billion by tax year 2008. EZ and TTA carryover credits would continue to be allowed to reduce tax below TMT. Under this bill, applied hiring credits are estimated at $95 million more than under current law. ($80 million decrease in credits generated - $95 million increase in carryover credits applied = -$15 million revenue loss.)

Taxable year estimates are converted to fiscal year estimates in the table above.

POLICY CONCERN

This bill would allow for an unlimited carryover period. Consequently, the department would be required to retain the carryover on the tax forms indefinitely. Recent credits have been enacted with a carryover period limitation because experience shows credits typically are exhausted within eight years of being earned.

LEGISLATIVE STAFF CONTACT

Nicole Kwon
Franchise Tax Board
(916) 845-7800
haeyoung.kwon@ftb.ca.gov

Brian Putler
Franchise Tax Board
(916) 845-6333
brian.putler@ftb.ca.gov